

S corporations allowed to own subsidiaries

Dear Reader:

I am writing to inform you about the opportunities to use an S corporation to hold stock of other corporations. S corporations may have 80%-or-more owned C ("regular") corporation subsidiaries and wholly-owned S corporation subsidiaries. Thus, taxpayers with S corporations have a great deal of flexibility in structuring their corporate holdings. Please call if you wish to explore the use of an S corporation to hold stock of other corporations.

Regular "C" corporation subsidiary. S corporations may have 80%-or-more-owned C corporation subsidiaries. These C corporation subsidiaries may file a consolidated return with other C corporations with which they are affiliated. The S corporation cannot be included in this return, however.

Note as well that dividends received by the S corporation parent from its C corporation subsidiary are not treated as "passive investment income" to the extent they are attributable to the sub's active conduct of a trade or business. This can help the S corporation avoid the tax on passive income and the possible termination of its S corporation status that applies to S corporations with accumulated earnings and profits (i.e., earnings and profits from a year when it was not an S corporation).

Wholly-owned S corporation subsidiary. An S corporation cannot have a corporate shareholder. This rule ordinarily prevents subsidiaries from being treated as S corporations. However, this rule does not apply to qualified Subchapter S subsidiaries (QSSSs or Qsubs). Thus, an S corporation can have a QSub if it owns 100% of the subsidiary and makes the required election.

A QSub is not treated as a separate corporation. Instead, its assets, liabilities, income, deductions, etc. are all treated as those of the parent S corporation. The sub's accumulated earnings and profits, passive investment income, and built-in gains are also treated as those of the parent. Other tax consequences relating to the S corporation sub can be complex. Please call if you would like me to analyze the benefits and costs of such an arrangement.

If an election is made to treat an existing corporation as a QSub, it will generally be treated as having liquidated in a tax-free subsidiary liquidation. The tax consequences of this move can be complex and must be thoroughly analyzed.

If you are interested in exploring any of these options further, please call.